RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038
26 LETTERS PER YEAR • $225 ANNUALLY

Jan. 27, 1988 **LETTER 983**

Jan 15 DJIA 1956.07; PTI 2634; A-D Ratio -11.10
Jan 22 DJIA 1903.51; PTI 2642; A-D Ratio -11.08
Current Dow Yield: 3.73%; Dow P/E: 13.5
Dow 200-day mov aver: 2275; Dow Pow: 690

THE PICTURE: My life would be a lot easier if the stock market would only follow directions (my directions, of course). Actually, the market does follow my directions at times, maybe two or three months a year — it's those other nine months that give me grey hair. But after the first 10 or 15 years in this business you either get philosophical or you're a prime candidate for the loony bin. So far, I've managed to stay philosophical and (I think) sane.

Part of my market philosophy goes something like this: (1) Face it, they don't run the New York Stock Exchange for Richard Russell's benefit. (2) If publishing a successful advisory report were easy, everybody would be doing it. But everybody isn't doing it. In fact most of the people in this business don't last very long. I've lasted for 30 years, so (I tell myself) maybe I'm doing something right. (3) The stock market is always logical. But brace yourself, Russell, the logic is very seldom understood at the time. (4) Where forecasting or even analyzing the action of the market is concerned, there's no such thing as perfection. There's nothing even remotely close to perfection -- so I'll just relax and do the best I can. (5) The primary trend of the market is the most reliable trend. The secondary trend can be deceptive. As far as the daily trend is concerned, forget trying to forecast it (commodity traders take note), it can't be done. And I emphasize this -- IT CAN'T BE DONE. (6) When in doubt about the minor or secondary trends (which is often), be guided in your investment stance by the prevailing primary trend. Eighty percent of the time you'll be right. (7) If you're intuitive, intelligent, and very diligent, you're probably going to be right too soon (about the market). Investors and the public hate analysts who are right too soon. I try to be guided accordingly.

All right, let's talk about what's happening. We experienced a bull market "top of tops" in 1987, and when I say that I mean we experienced a market with all the characteristics of a classic, text-book top. We saw extreme overvaluation, we saw minuscule yields and inflated price/earnings ratios. We saw record volume and rampant speculation. We saw many stocks rising as much in a day as their accumulated dividends would add up to in five or even 10 years. We saw massive sales to the public of questionable stocks and junk bonds. We saw the Wall Street rumor mills (takeovers, mergers, acquisitions) in high, high gear. And we listened to a chorus of latter-day gurus all promising us that Dow 3000 to 3600, even 4000, was only a matter of time.

As I said, this was a top so classic that it will probably be written about in text books 25 or 50 years from now. Next came a Dow Theory bear signal on October 15. If there were any doubts about this being a primary bear market, those doubts should have been eliminated on October 19 when the market crashed with the Dow falling a stupefying, historic 508 points.

The crash ended at 1738.74 for the Dow, 674.92 for the Transports, 160.98 for the Utilities. A two–day rally followed, after which the market headed down again. On the second decline the Transports hit a new low of 661.00 (Dec. 4), but the Dow refused to confirm (you can see it all on the page-one chart). The downside non-confirmation set off a good rally, and by January 7 both Averages had bettered their October 21 highs.

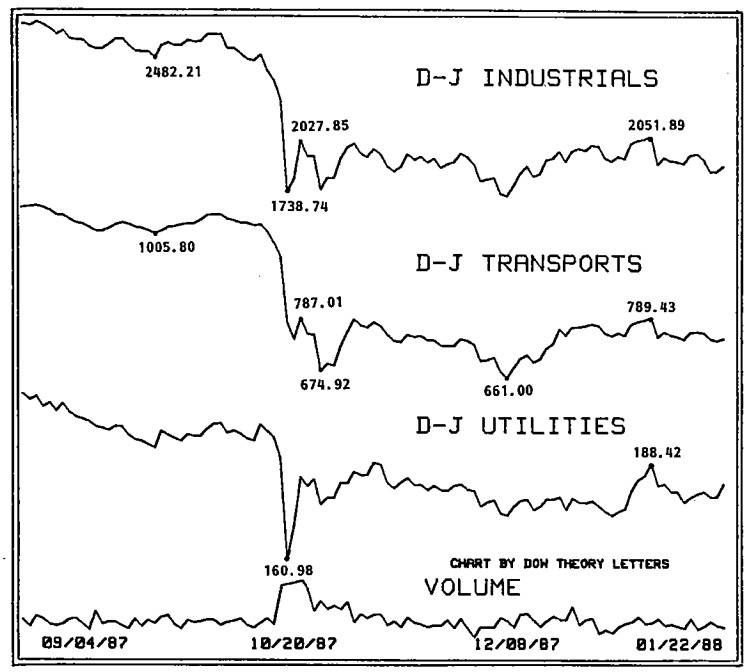
Had this been a bull market, there's no doubt in my mind that the bettering of the October 21 highs would have triggered a major advance. But this is a bear market, and the bear isn't in the business of generating profits for investors and traders. No sooner did the Averages better their October 21 highs (on January 7) than the market dumped again, with the Dow dropping 140 points in a single day.

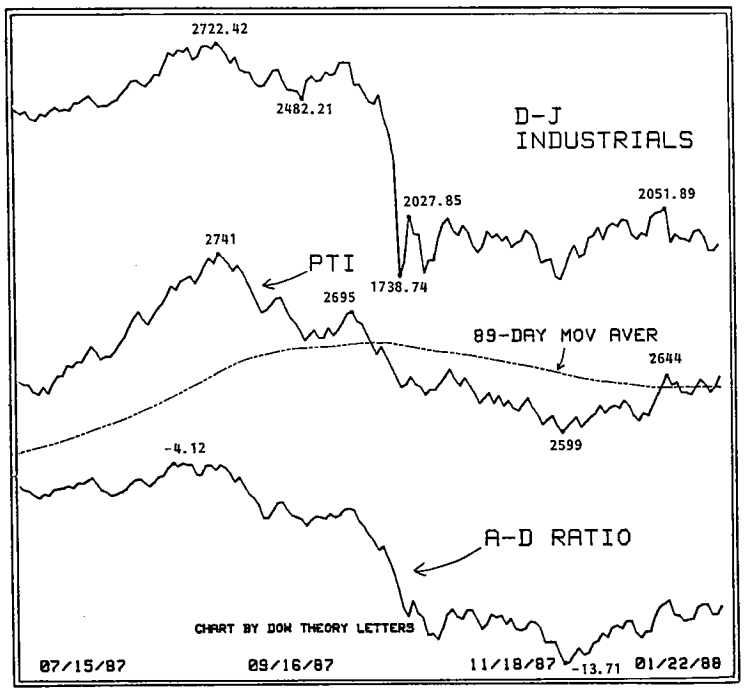
WHERE ARE WE? As I analyze the situation, we are **still in the first phase** of the bear market. This is the phase where stocks go down for no reason that is visible in the economy (actually, stocks are going down because the "big boys" are quietly leaving the scene).

The **second phase** of the bear market (and this is usually the longest and most deceptive phase) still lies ahead. During the second phase stocks go down in response to obviously deteriorating business conditions.

The **third phase** of a bear market is the liquidation phase, the phase where good stocks are thrown over with the bad -- thrown over because money has to be raised. The third phase is the phase that sees stocks sink below known values, and it's the "give-up" phase for the great majority of stockholders. (Note: The phases are based on market psychology, and have little or nothing to do with the price action.)

PRICE MOVEMENT: As I write this, the Averages are fluctuating in what I call "no-man's land." This is always the **most difficult area to deal with** (as opposed, for instance, to when the Averages are breaking out into new (primary) high territory or breaking down into new (primary) low territory). So here we are in no-man's land with the D-J Averages fluctuating between the last secondary peaks (in this case the January 7 peaks of 2051.89 and





789.43 -- see chart) and the primary lows (i.e., the extreme lows) of the bear market, which were 1738.74 and 661.00.

With the Averages now in no-man's land, here are a few of my thoughts:

(1) According to Dow Theory the trend is taken to remain in force until proved otherwise. The primary trend was confirmed as bearish only a few months ago (on October 15), and all my studies suggest that the bear should be in command for at least the next one, two, or three years. Therefore, I operate on the basic assumption that the bear market lives.

(2) There have never been so many analysts engaged in trying to "psych out" or figure out the stock market. Never has so much money been involved in the stock market. Never have so many professionals been engaged in trying to operate correctly in the market (I should know because never have my subscription lists been so filled with banks, institutional managers, brokerage house analysts, pension fund managers, etc.). Because of this phenomenon, the bear is going to have to work overtime and be more deceptive than ever if he is going to do "his thing" — and his thing is to take this market DOWN while keeping as many investors in the market as possible (a diabolical plot, but let's face it, the bear's a monster).

(3) It's obvious from everything that has been going on that the government and the Fed are going to fight any and all indications of economic contraction. They'll fight contraction with bail-outs, loans, lower interest rates, monetary expansion, new spending plans, and more deficits. This procedure isn't going to reverse the primary bear trend, but it most definitely will PROLONG the bear market. In fact, we could easily have mini-bull and bear markets within the framework of the major bear trend. But don't be fooled -- the overall primary trend is down. It's simply a matter of how this market goes down, how far it goes down, and how long it takes to get there.

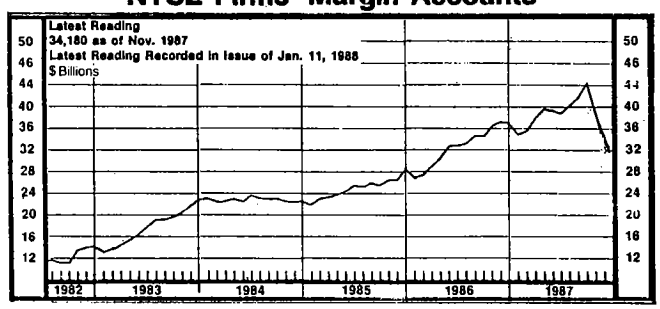
On the downside, the points to watch now are simply the bear market lows of 1738.74 for Industrial, 661.00 for Transports. If those lows are jointly broken the bear market will be reconfirmed. On the upside there is the Industrials peak of 2051.89 and the Transport peak of 78943. A joint bettering of those two peaks would turn the **secondary** trend to the bull side.

COMMENTS: The 200-day moving average of the Dow is declining at the rate of 1 to 2 points per day -- it currently stands at 2282. ... Of the 30 stocks that make up the Dow, ALL 30 are now below their prices of six months ago (when's the last time you saw that?). The best Dow performers are: Beth Steel, down 7.9%; AT&T, down 7.9%, and Boeing Co., down 10.4%. Worst performers are; DuPont, down 35.9%; Woolworth, down 37.3%, and Navistar down 47.6%. ... IBM, the powerhouse and bellwether of the Dow, is considered a proxy for the whole US economy. IBM is now fluctuating below its lows of 1985, '86, and '87. The 1984 low for IBM was 98. Watch that number.

One of the characteristics of a bear market is that it drives the public and the speculators out of the market (due to persistent losses, of course). In fact the January 20 WSJ featured a front-page article which was headlined, "Out of Action -- Many Small Investors, Frightened by the Crash, Stay on the Sidelines." In the same issue the WSJ reported that discount broker Charles Schwab expects to report a fourth-quarter loss of up to $15 million. (By the way, veteran brokers from major Wall Street firms tell me they haven't seen business as slow since the 1960s).

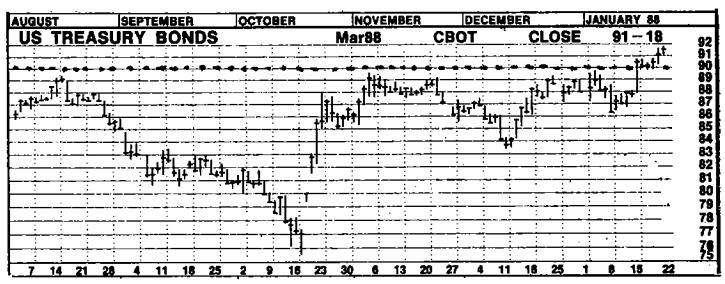
During the life of a bear market it is characteristic to see NYSE margin accounts decline. Margins decline as the speculators (who almost always use margin) are beaten and battered by the bear and driven out of the market. This chart shows the beginning of this process, with a huge drop of over $8 billion in margins since the high. Expect this process to continue for the life of the bear market.

NYSE Firms' Margin Accounts



Until very recently, stocks were extremely sensitive to the bond action. When bonds rallied (as long-term interest rates declined) stocks rallied. This interaction seems to be ending. Stocks now go down even when bonds advance. In a primary bear market, stocks go down because they are discounting poor business ahead and contracting corporate profits. But in a market that is discounting recession, bonds (and I emphasize high-grade bonds) will rise as they anticipate lower interest rates and a drop in the demand for money.

Subscribers know that I have been bullish on the bond market and have stated that I personally have assumed a large position in high-grade municipal bonds. So far, this position has paid off handsomely. The accompanying chart shows the breakout last week in the March T-bond contract. Long-term Treasury bond yields have now dropped below 9%. If a world recession is on the horizon (and it could well be), I foresee a concerted international effort to bring rates down. Since the crash lows, the T-bonds have rallied roughly 20%, which should make all of us who bought bonds happy.



INVESTMENT POSITION: My investment position has been clear ever since last July and August. Certainly it 's been crystal clear since October 15 (which was the day of the primary bear signal). My position is that this is a bear market, and therefore we sell equities and get on the sidelines.

I guess somehow I didn't get all this across to a few subscribers because when we got the fake breakout of the Averages on January 7 some people thought it was a signal to buy. It wasn't. In a bear market we sell stocks during rallies, not buy. I very seldom advocate buying in bear markets -- even though the bear can and will produce some whopping rallies.

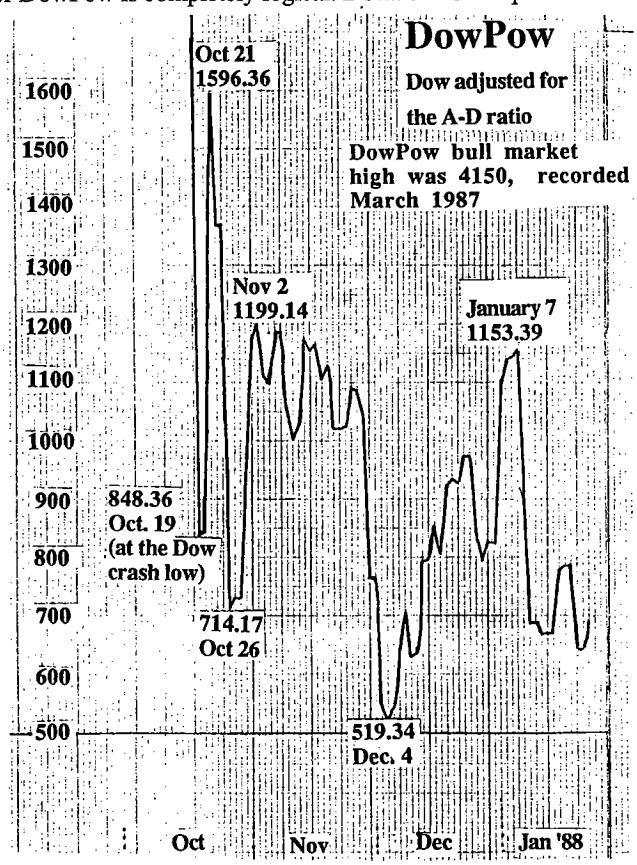
Many people have trouble believing the written word, and for them I have included illustrations or symbols for the recommended action. The bull in this box would mean "bull market, buy, be in stocks." The bear which is now in this box means "bear market, sell, be out of stocks."

DOWPOW: Please excuse me for being so fascinated with my proprietary indicator, but I must admit that the action of DowPow continues to fascinate me.

The reason DowPow's action draws my attention is that this indicator is so logical and cold-blooded. It is based solely on market action. DowPow represents the Dow's action adjusted for the action of the advances and declines on the NYSE.

So far, as you can see on this daily chart, DowPow has tended to be powerful on the downside, weak on the upside. In its action, DowPow has actually presented the picture of a market that is weaker than what we would have suspected from just examining the action of any of the major stock averages. As of this writing, DowPow is not far from its December 4 bear market low.

Is the DowPow picture the correct one? I believe it is. The make-up of DowPow is completely logical. DowPow is computed in exactly the same way each day. There is no hanky-panky here. So it will be most interesting to see whether DowPow is "telling the truth" about this market. We should know soon. As I said, the action of DowPow continues to fascinate me.



BEARISH BIAS? According to Dow Theory, we are now in a bear market. Since I am a follower of Dow's Theory, I obviously believe we are in for tough times in the market and in the economy. But how tough? How bearish should I be? I don't want newer subscribers to think that Richard Russell has some sort of built-in bearish bias, so let me put it this way -- my bearishness from here on will be guided very much by the action of the Dow in relation to the 50% Principle.

The next question might be -- "Is there any study which can provide information as to **how far** this bear market might eventually carry?" The answer is that there is one technical tool that can be of great value in estimating how far the bear market might ultimately carry. That tool is **DOW'S 50% PRINCIPLE.** I have written about the 50% Principle on a number of occasions over the years, the last time being in Letter 979.

More recently, I wrote an article which appeared in **Barron's** (Jan. 18 issue). I wrote it because I believe that the 50% Principle represents the most **important** concept in the entire market spectrum at this time. For this reason, (and because many of my subscribers don't read *Barron's*) I have included a copy of the *Barron's* article in this Letter on page 4.

In the *Barron's* article I presented the 50% Principle in terms of the whole span of the 1974-1987 bull market. The halfway or 50% level of the 1974-87 rise is Dow **1650** -- that is **THE critical level.**

However it is interesting and informative to apply the 50% Principle to the five-year Dow rise of 1982 to 1987 and again to the lesser three-year Dow rise of 1984 to 1987.

But first I suggest that you read (or re-read) the *Barron's* article carefully. Get the concept firmly in mind. Now ponder the following: The rise from the 1982 low to the1987 peak took the Dow from 776.92 to 2722.42. The halfway or 50% level of that

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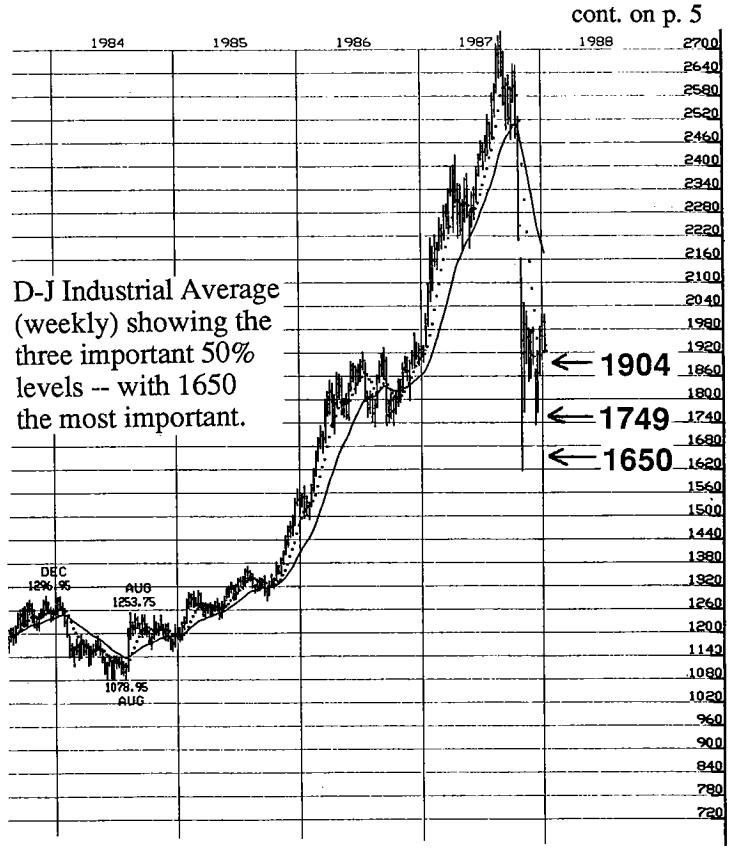

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.....Jan. 27, 1988

The 50% Principle

A Dow Theorist Views a Critical Indicator

By RICHARD RUSSELL

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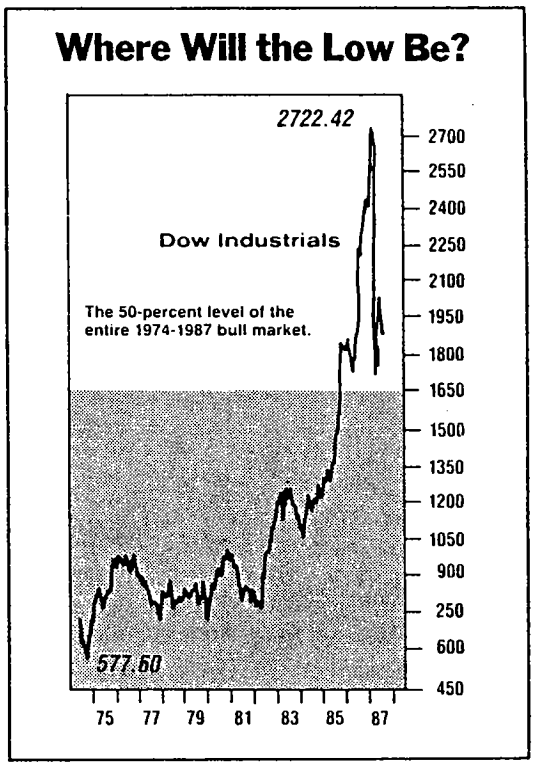
ON OCT. 15, a primary bear market was signaled under the Dow Theory, a fact duly noted in an article that appeared in the Oct. 19 issue of *Barron's*. A second piece, which appeared in the Oct. 26 issue, warned that the bear market promised to be both extended and costly, for two reasons: Bear markets tend to last one-quarter to one-third as long as the preceding bull market, and bear markets exist for the purpose of correcting the excesses of the preceding bull markets. Furthermore, the greater the bull market excesses, the more drastic the bear market that will ultimately follow.

The late bull market was a very long one, lasting from 1974 to 1987, a period of 13 years. The bull market also created an enormous amount of excesses, not the least of which was extreme overvaluation in stocks. At the peak, in August 1987, the Dow Jones Industrial Average was yielding 2.56%, one of the lowest Dow yields at a bull-market peak in history. So both the length of the 1974-87 bull market and its flagrant overvaluation at the highs suggested a major bear market to follow. It is my opinion that we are in the early stage of that bear market now.

Are there any gauges or landmarks that may be useful at this point? There is one, and it is relatively unknown. It is called Dow's 50% Principle, and it is of singular and critical importance at this juncture.

I learned about the 50% Principle and its application from the late Dow Theorist E. George Schaefer. I corresponded with Schaefer for many years, and, among other things, he often spoke of and wrote about the 50% Principle. Schaefer told me that he dug out the principle from an exhaustive study that he made of Charles H. Dow's writing. Schaefer, being a brilliant innovator, combined several additional studies with the Classic Dow Theory. The 50% Principle was one of them.

During the 'Fifties and 'Sixties, Schaefer published about a dozen special studies of Dow's 50% Principle. He used these studies on a number of occasions—first in identifying the absolute start of the 1949 bull market and later in correctly calling for the bull market's continuance—right up to the time of that bull market's final top in 1966.



I have followed the 50% Principle on my own for over 30 years. The Principle is applicable only on rare occasions, and today's market offers one of them. I might preface this by saying that although a number of market analysts have heard of the 50% Principle, very few of them understand it or use it correctly.

The 50% Principle should be applied only to major, extended market movements. It is of little value in gauging daily or weekly movements. The principle is also most valid when applied to an average or index rather than to an individual stock.

How can the 50% Principle be used in the current market situation? The 1974-87 bull market began at a December 1974 low of 577.60 on the Dow. The bull market carried to an August 1987 peak of 2722.42. Thus, the bull market saw the Dow rise a total of 2144.82 points. The midway, or 50%, level of that enormous rise is 1650.01.

According to the 50% Principle, if, during a decline, the price movement can hold above the halfway (50%) level of the preceding major advance, it is a very constructive indication. It is a sign suggesting that in due time the price movement will approach or even better the old high again.

Conversely, if, during a decline, the price movement breaks decisively below the 50% level of the previous major advance, it is an extremely bearish indication. The odds would favor a further decline, a decline that could take the price movement near or even back to the level at which the entire preceding bull movement began.

Stocks and stock averages have weight, movement, and momentum. They tend to rise and fall in line with some of the basic laws of physics. In using Dow's 50% Principle, it may help to visualize the price action in the form of a child's see-saw. Two children, A and B, sit at opposite ends of the see-saw. A sits on the high end of the see-saw and B sits at the low end on the ground. A's end starts to descend. It declines almost, but not quite, to the horizontal position, but failing to sink below the horizontal position. A's end of the see-saw then rises to the high position again. A declines again, but this time A drops below the horizontal position. A's end of the see-saw then descends all the way, until A's feet are on the ground.

In this example, the horizontal position of the see-saw corresponds to the halfway level of the market advance and A represents the price movement. It can readily be seen that the critical question is whether, on the descent, A (that is, the Dow) will hold above the halfway level of its span or whether A will drop below the 50% (the horizontal) level of its span (the span being the preceding bull market).

What about the 50% Principle as actually applied to the current market? If the Dow can consolidate and establish its ultimate bear market low *above 1650*, or the halfway level of the 1974-87 rise, such action would constitute a very important technical plus.

However, if during the course of this bear market, the Dow falls decisively below 1650, I would take this as an ominously bearish indication. It would be a sign that this bear market has considerably further to go on the downside. If so, I believe the Dow could sink below 1000 before this bear market breathes its last. It goes without saying that a Dow below 1650 would be a most bearish omen not only for the stock market but for the health and well-being of this nation as well.

A final observation: The pattern of the Dow has now assumed the form of a massive head-and-shoulders top with critical support at 1720. Consequently, I would consider any Dow decline to 1720 or below to represent a major technical breakdown. If a decline to 1720 does materialize, I believe the Dow will quickly drop to, and then below, the critical 1650 level—into the disaster area identified by Dow's 50% Principle. ■

Richard Russell is editor and publisher of Dow Theory Letters in La Jolla, Calif.

rise is **1749.** Now let's take the rise from the 1984 low of 1086.58 to the 1987 high of 2722.42. The halfway level of that rise is **1904.**

I have included here a weekly chart of the Dow covering the last four years. The chart identifies the three 50% levels -- by far the most important of the three, of course, is the 1650 level.

What I find so fascinating is how the Dow at present is fluctuating in the area of the three 50% levels. You can almost "feel" the technical struggle, and as you study the chart you can sense the tremendous importance of this battle as the Dow rallies and declines in this area.

You can also sense the bearish implications if the Dow closes first below 1904, then below 1749, and finally below 1650. What you see here is the real struggle that is going on in the stock market. Whether the Dow holds above these levels (and most importantly above 1650) is the single most important consideration for Wall Street and the nation today.

CHART BOOKS: I publish two chart books which I feel are indispensable for all serious investors and students of the stock market. The first is an album which includes a chart for each year going back to 1885. Each year's chart (plotted daily) traces the action of the D-J Industrials, Transports, Utilities, and Bonds, plus daily volume. Important news events affecting the market are shown. This material is available nowhere else.

The second album traces the Dow and the advance-decline ratio back to 1931, daily, and again there is a page for each year. Important non-confirmations are shown.

The two albums present material for study and comparison; hardly a week goes by that I don't refer to them in my work. The pages are large -- 11x17-inch and are arranged in a hard-cover three-ring binder so that each new year's page can be added. Price for the D-J Averages album is $135, price for the A-D album is $95. **Please** make checks out to Richard Russell. We pay the postage.

IMPORTANT: For those who already own the albums, the new 1987 pages are now ready, price $2 per page. Please specify which pages you need, D-J Averages or A-D.

NOTES & QUOTES: The Reagan Administration estimates next year's federal deficit at $136 billion. The Congressional Budget Committee has just come out with their estimate -- a $165 billion deficit. Ed Hyman of C.J. Lawrence states in his January 11 report: "The 1989 deficit is likely to be over $180 billion, in our view." Who should you believe? The Russell advice -- believe Ed Hyman (considered by many to be the top economist in the nation) and hope it isn't worse.

* *

Bets? It's against the law to bet on a US election in Vegas, but here are the latest British bookie odds: Bush a 3-2 favorite to win, Dole 2-1 to win, Dukakis leads the Dems at 6-1 to win, Haig and Robertson at 12-1, Gephardt and Simon 14-1, Hart 16-1, Jackson 40-1, Gore and Kemp 50-1, Babbitt 66-1, and duPont 100-1.

* *

Self-Promotion Dept: Mark Hulbert (who tracks the various advisory services) was interviewed for the current issue of the *Mansfield Chart Service.* Here's a section of that interview:

Mansfield: Were there any particularly strong bearish opinions on the part of the advisory letters before the crash?

Hulbert: No one predicted the 508-point drop, but there were some who negotiated the Crash better than others. I'll just mention a few of them although I do not want you to think these are the only ones who did well (by the best performers, by the way, I don't mean to include those advisers who were bearish all along in the months leading up to the Crash. Instead,I mean those who turned from bullish to bearish near the top and before October 19).

Richard Russell, editor of DOW THEORY LETTERS is one such adviser. His newsletter turned from bullish to bearish in September, and he himself -- at the *Investment Seminar Inc.* conference in San Francisco that I attended in late August -- turned bearish within days of the top. In addition, he gave the parameters for a Dow Theory sell signal which were met on October 15, giving close followers of this Theory time to get out before the Massacre (Hulbert then mentions one other service, ZWEIG FORECASTS, written by friend Marty Zweig in NYC).

* *

Oh great! San Diego has now moved to the No. 1 spot on the "least-affordable" homes list. This means that in terms of average household income, San Diego homes are now the most expensive in the nation. The accompanying list tells the story. (Meet me in St.Louie where the livin' is easier.)

Least-Affordable Homes:

	Payment to Income
1. San Diego	33.3%
2. New York City area	33.1%
3. Boston area	32.9%
4. Los Angeles area	31.7%
5. Denver-Boulder	29.3%
6. Salt Lake City	28.7%
7. San Francisco Bay area	28.2%
8. Phoenix	28.2%
9. Minneapolis-St.Paul	28.1%
10. Washington, D.C.	27.5%

(U.S. average = 28%)

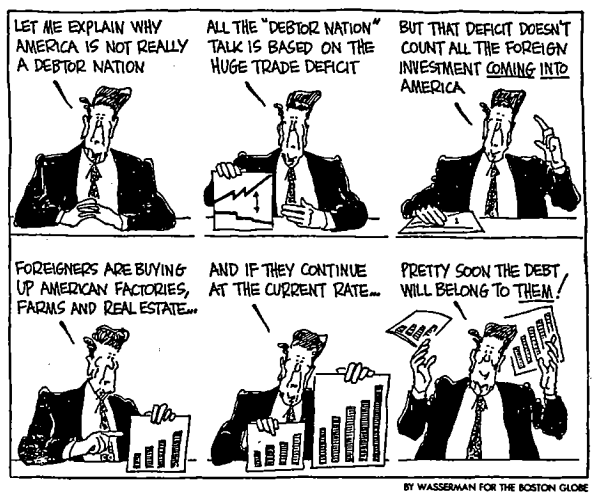
Most-Affordable Homes:

	Payment to Income
1. St. Louis	18.2%
2. Cleveland-Akron-Lorain	20.2%
3. Indianapolis	22.1%
4. Miami-Ft.Lauderdale	22.1%
5. Kansas City	22.9%
6. Columbus	23.0%
7. Detroit-Ann Arbor	23.4%
8. Tampa-St.Petersburg	24.8%
9. Chicago Area	24.8%
10. Philadelphia	25.1%

(U.S. average = 28%)

* *

As he gets older, our President is sounding goofier, so goofy, in fact, that people have even stopped laughing at his eccentric comments, the latest being that the US trade deficits are actually a sign of economic strength. Here's cartoonist Wasserman's view of the Prez, and as you can see the cartoon makes good-natured fun of Mr. Reagan. People still like the Prez, even if he is sounding progressivly mmmmm a-hem as the days and weeks go by.


LET ME EXPLAIN WHY AMERICA IS NOT REALLY A DEBTOR NATION
ALL THE "DEBTOR NATION" TALK IS BASED ON THE HUGE TRADE DEFICIT
BUT THAT DEFICIT DOESN'T COUNT ALL THE FOREIGN INVESTMENT COMING INTO AMERICA
FOREIGNERS ARE BUYING UP AMERICAN FACTORIES, FARMS AND REAL ESTATE...
AND IF THEY CONTINUE AT THE CURRENT RATE...
PRETTY SOON THE DEBT WILL BELONG TO THEM!
BY WASSERMAN FOR THE BOSTON GLOBE

* *

What went where last year? NASDAQ was **down** 5.26%, the S&P Transports were down 3.6%, the S&P Utilities were down 9.06%, the S&P Financials were down 19.5%, the trade-weighted dollar was down 15.8%, and the dollar was down 23.5% against the yen.

The Dow was **up** 2.26%, the Nikkei index was up 15.3%, OPEC oil was up 4. 96% per barrel, gold was up 21.9%.

* *

Oil time-bomb still ticking: Last year US oil production dropped 4.5% to the lowest level since 1977, while at the same time US demand rose 1.8%, twice what was expected. As a result, the US had to boost its oil imports to 6.5 million barrels a day. US dependence on foreign oil is now higher than it was in 1973-74 -- at the time of the Arab embargo. Oil is a key factor in the US trade deficit. In October alone, for example, the US bought $4.3 billion of

oil. The '87 US production drop was the second in a row and was 14% below 1970's production (1970 was the US's biggest oil production year). One thing that's happened -- the low oil price has discouraged US exploration and production.

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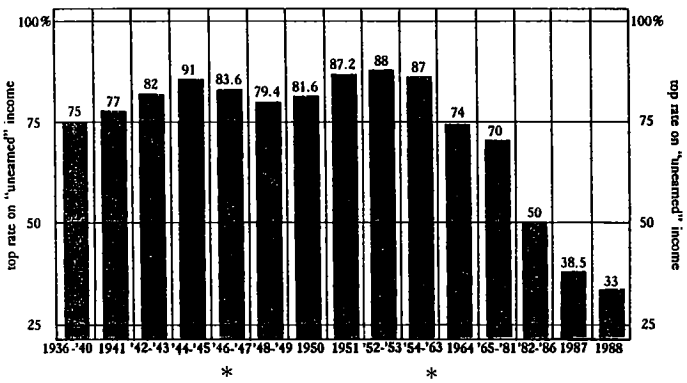
Inflationary pressures are appearing, but bonds, nevertheless, have been acting fairly well. One reason for the decent bond action is the move to lower rates in Europe and Japan (making US bonds more competitive).

As readers know, I have liked muni bonds, particularly for those living in high-tax states. Speaking of taxes, this chart shows the top US tax rate on "unearned income," and the chart goes all the way back to 1936. What this chart tells me (wealthy subscribers, take note) is that here in 1988 we are probably seeing the LOWEST top rates we're ever going to see. From here on, I'm guessing the top rate will head higher, just watch the next Congress. If I'm right, there's only one place to hide. You guessed it -- muni bonds (chart courtesy of *Grant's Interest Rate Observer,* 233 B'way, NYC 10279. Grant's, by the way, is one of my favorite publications).



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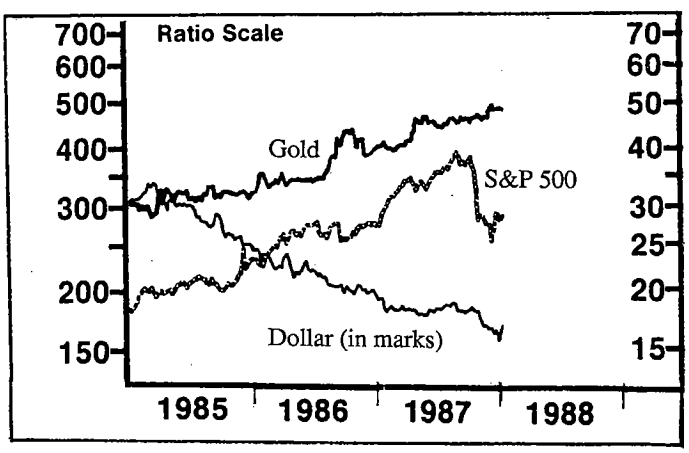
Condo prices may be easing in NYC, but don't kid yourself -- there are still a lot of bucks in Gotham. "The Phantom of the Opera" hasn't opened yet, but advance sales are already $17 million, and good tickets are not available until next November!

GOLD: What's the matter with me? I hear all kinds of bearish predictions about gold -- it's in a down cycle, there're too much of it being produced, it didn't explode when the dollar collapsed, gold will sell at 100 when this economy deflates, and on and on. But I continue to buy more gold coins around the first of every month, and I don't seem to worry about gold. Usually, when I'm doing the wrong thing I get a sick feeling in the pit of my stomach. And here in 1988 I'm still feeling good.

The truth is that I'm just following the same strategy that I suggested to my subscribers. The strategy is -- "Don't try to outguess or outsmart gold." Just tell yourself that you're diversifying a certain portion of your assets into real money (i.e., gold), and continue to dollar average into gold. Buy a fixed dollar amount of gold coins each month, put 'em in the lock box -- and then forget gold until the first of next month. Next month if the price is down you'll be buying more gold for your dollars. If the price is up, you can tell your spouse or your mother how smart you've been to have bought gold at lower prices and let it go at that.



This little chart (courtesy of *M/G Financial Weekly*) tells an interesting story. From its 1985 price of 315, gold advanced to just over 500 last December, a rise of 60%. The chart shows a gold comparison in terms of the S & P 500 and in terms of the dollar (the dollar in marks). Only gold is still in a bull market. All in all, not too shabby a performance for gold.

LATE NOTES: One of the items I'm mulling over now is the STRENGTH IN THE BOND MARKET. The bonds have now formed a huge bottom formation (see page 2 chart), and they are moving. The direction is UP. The March T-bond contract has now pushed above important resistance at 90, and the next upside target is 94. If the March contract can get above 94, it's going to try for the 1987 highs of just above 105 (which I must admit seems a bit far-fetched at this time).

But I ask myself, "Why -- why are the bonds so strong?" I'm not asking this question merely because I recommended bonds and I'm personally loaded with (muni) bonds. I'm asking the question because the strength in the bonds must be telling us something, something important about coming events.

One possibility I see is a slowdown in the consumer sector of the economy (the consumer sector represents two-thirds of the GNP) and at the same time an export-driven rise in the manufacturing sector of the economy. This would give us a mixed, difficult, tricky stock market (which we already have) and a sluggish economy, probably a low level of inflation, and almost surely a rising bond market.

On top of this, if the Fed perceived that the consumer sector was contracting (particularly in a pre-election year) they could move to bring interest rates down. I might add that US rates are still well above foreign rates, and this militates toward foreigners buying US bonds for the yield advantage.

Finally, I'm reasonably sure that the dollar has bottomed out. If this is true, it would give foreign buyers of US bonds confidence and more incentive to buy US bonds. Add to this the fact that our trade balance deficit is shrinking and you have the formula for a further rise in bonds.

How will all this affect the stock market? First, I should note that my PTI has pushed ABOVE its 89-day moving average. The PTI is my fail-safe indicator, and the PTI is now in the process of trending higher. I use the PTI in conjuction with DowPow, and as noted earlier DowPow still acts poorly. The verdict: A standoff between these two proprietary indicators.

As this is written the Averages are still in "no man's land" although they seem to "want to" push higher. Is the market (finally) ready for the long-awaited secondary (upward) correction? We should know more by the time the next Letter is mailed, and it's (unfortunately) still too early for me to get a handle on the secondary trend.

Overall Conclusion: There's always a Big Picture, and this is how I see it. The stock market formed a major, historic top in August 1987. A Dow Theory bear signal and crash followed, and that was the market's way of announcing that "the tide has turned." Since the crash the market has been fluctuating in no-man's land, and I believe that the stock market is now trying to measure the distance from here to the next obvious downturn (i.e., recession) in the economy. The eventual recession could be a month away or it could be a year away, but the market has said that the BEST HAS ALREADY BEEN SEEN IN THE ECONOMY. The bear is now resting -- and watching. And while he's resting he's gathering strength for his next onslaught. When the bear rests, when selling pressure eases up, the stock market floats higher -- temporarily.

NEXT MAILING: Feb. 10